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ABSTRACT

Information is presented on 1980-81 tax performance and educational spending in Southern Regional Education Board (SREB) states, the relationship of state and local taxes to personal income in all the states, and utilization of tax ability and major tax bases. Additionally, factors producing serious state and local budgetary problems are identified, including the low rate of economic growth, tax policy, and the link between state-local income tax regulations and federal income tax rules. For the SREB states, information is presented on: per pupil expenditure for elementary and secondary education; per capita appropriations for higher education; and state appropriations for higher educational operations as a percent of state taxes ranked against state and local support of elementary and secondary education. States that rank among the highest in their tax contribution to higher education are lowest in support of elementary and secondary schools. In 1980, state and local taxes collected in the United States per $1,000 of personal income amounted to $110.75. Major tax sources (general sales, selective sales, property, individual income, and corporation income) are compared to the 14 SREB States and for the other regions aggregately. For 1980-81, tax and spending reduction were somewhat more common than tax increases. Among the SREB states, inflation-adjusted declines in higher education funding were especially serious in Arkansas, Alabama, Tennessee, and South Carolina. The declines occur at a time of reduced federal support. On a per capita basis, seven SREB states are above the average in support of higher education: Alabama, Louisiana, Mississippi, North Carolina, South Carolina, Texas, and Virginia. Maryland is the only SREB state that exceeds the national average in support of elementary and secondary education. (SW)

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FINANCING HIGHER EDUCATION

A Service of the Southern Regional Education Board

1340 Spring Street, N.W. Atlanta, Georgia 30309

STATE-LOCAL TAXATION AND HIGHER EDUCATION FINANCING

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State-Local Taxation and Higher Education Financing

State Revenue and Higher Education

Few programs are affected more sharply than higher education when state revenue shortfalls lead to budget cutbacks. And, state budget cutbacks were common in 1980 and 1981 in all but a few high-priority activities. Given the current economic slowdown, the picture is not likely to brighten much in the near future.

Complicating the situation is the fact that many state and local programs have depended heavily on federal funds. The 1981 fiscal year marked the third consecutive year in which the purchasing power of federal financial transfers to states and local governments, measured in constant dollars, has fallen. Now cutbacks in current dollars also can be anticipated.

State support for higher education in the nation has not kept pace with inflation in the last two academic years. State appropriations advanced 20 percent, but in real dollars, as measured by the Consumer Price Index, this amounted to an actual decline of 14 percent from 1980 to 1982. A total of 34 states fell behind inflation in higher educational support in the period. This decline came at a time when federal support was already being reduced, leaving the states with a larger share of financing responsibilities.[1] In recent years, state appropriations have grown slightly as a part of higher education budgets, while federal dollars have declined and tuition income remained about the same share.

Among the SREB states, inflation-adjusted declines in higher education funding were especially serious in Arkansas, Alabama, Tennessee, and South Carolina. Inflation-adjusted reductions ranged from 2 percent to 13 percent in nine SREB states. The oil producing states of Louisiana and Texas experienced increases of 10 percent and 16 percent, respectively.

There are several reasons why state-local fiscal health has been below average in recent years. One major reason has been the low rate of economic growth. Inflation and the threat of an extended economic slowdown continue to dominate the growth picture. In many states, taxes lagged behind inflation in both 1979 and 1980. In 1980, revenues kept pace with inflation in only nine states of the nation. Inflation-adjusted taxes actually declined by one and a half billion dollars in 1979 and by half a billion dollars in 1980. But while most states were struggling to balance their budgets, a few states were enjoying financial prosperity. Among them were Alaska, Montana, North Dakota, and Wyoming, which joined those states historically prominent as energy producers. On the other hand, states with extraordinary dependence on the lumber and automobile industries had sharp revenue drops.

A contributing reason for recent budget problems is past tax policy. A build-up of budget surpluses and taxpayer resistance in the late 1970s encouraged states to adopt tax rebates and lower rates, leaving little cushion for potential tax shortfalls. State-local tax spending constraints and legislated spending mandates also have contributed to tighter budgets.

In 1981, 27 states reported budget surpluses of 3 percent or less of general fund spending (six SREB states) and five more from 4 to 5 percent (one SREB state).[2] A surplus of at least 5 percent is considered desirable according to traditional standards. Most states reporting low surpluses have relatively weak economies or have recently reduced taxes.

Tax reductions have been much more common than tax increases in recent years. In addition to the proliferation of tax rebates, exemptions, and lower rates, a number of states have indexed their income taxes — to keep taxpayers from being pushed into higher brackets solely because of inflation. The rate of future growth is reduced by all of these, in many cases well below a state's economic growth.

Federal budget policy also affects the state-local revenue outlook. Both current and real dollars in federal aid are expected to decline further in 1982 and 1983. Several categorical grant programs will be replaced by a few block grants at substantially fewer

[1] Statements in this and the following paragraph are based on Jack Magarrell, "Prices Outrun Aid to Colleges in 34 States," *The Chronicle of Higher Education*, Vol. XXIII, No. 8, October 21, 1981, pp. 10-13.

[2] Steven D. Gold, "The Struggles of 1981: Budget Action in the States," *State Legislatures*, the National Conference of State Legislators, July/August, 1981, pp. 22-27. SREB states reporting surpluses of 3 percent or less were Arkansas, Kentucky, Maryland, Mississippi, South Carolina, and Tennessee. North Carolina reported a 4 or 5 percent surplus.

dollars, if the administration program is approved by Congress.

State corporation and personal income taxes will also be reduced substantially for states which tie their income tax regulations to federal income tax rules. Reductions in 1982 collections of income taxes amounting to $1.6 billion ($250 million in the SREB states) and losses substantially larger in later years have been estimated. The SREB states can expect to lose a total of $5.1 billion in income taxes in the years 1981 to 1986 if they continue to make their income tax rules conform to the federal rules, although some of this potential loss may be recovered in higher sales taxes as federal income taxes are reduced.

Taken together, these factors produce serious state-local budgetary problems. The most severely affected states must either cut spending further or raise taxes. The most common recent practice has been to reduce spending and keep tax increases to a minimum. The many spending reductions have resulted in modest growth or no growth in many activities — and cuts in some.

Tax Performance and Educational Spending

The general objective of the SREB tax performance analyses is to provide improved information on how state and local tax dollars — the major source of higher educational support — can be used more effectively in each of the states. Sometimes the focus has been on the overall pattern of tax bases used by states, sometimes on the extent to which particular taxes are utilized in comparison with their average use, sometimes on comparisons of the "over" or "under" utilization of taxes in the aggregate.

Although higher educational appropriations as a share of total taxes have often been displayed and discussed, less attention has been given to analyzing the range in commitment to higher education which these shares reveal among SREB states — from 11.7 percent of state taxes in Maryland to 20.3 percent in Alabama during 1980. These variations are due in part to the size of the private versus the public higher educational structure, level of support from tuition and other sources of revenue, proportion of enrollment at two-year institutions, and comprehensiveness of program areas included in a state system.

In considering state commitment to education, questions are sometimes raised about the relationship of higher education to elementary and secondary education. A frequently quoted measure of higher educational support is appropriations for higher educational operations per capita, and a measure of elementary and secondary educational support is expenditure per pupil. In Table 1 these two measures are shown for the SREB states and, for comparative purposes, are also expressed as percentages of the national average. According to these measures, only one of the SREB states (Maryland) exceeds the national average in support of its elementary and secondary schools. On a per capita basis, seven of the SREB states are above the national average in support of higher education (Alabama, Louisiana, Mississippi, North Carolina, South Carolina, Texas, and Virginia). Several of these states have nationally recognized research universities which rank with the best in the country.

Higher educational support, of course, may also be gauged by showing appropriations as a percent of state taxes. Ranking the states according to this measure against state and local support of the schools provides a picture reflecting a wide range of state priorities (Table 2). States which rank among the highest in support of local schools are revealed as lowest in their tax contribution to higher education, while some of the strongest supporters of higher education are lowest in support of the schools.

There may be eminently good reasons for a state to give much greater priority to one level of education than to the other. As noted, several states with above average appropriations for higher education have universities that are recognized nationally for scholarship and research. Less affluent states which desire to provide a full array of higher education programs and to compete on a national level will find that such a commitment may consume an above average share of state tax revenues. Reports from colleges and universities on inadequately prepared high school graduates may support a rationale for stepping up funding allocations to the elementary and secondary schools and ultimately relieving higher education of much remedial work which is now necessary. A historical tradition of high tuition may dispose governors and legislators to consider a

Table 1

Per Pupil Expenditures for Elementary and Secondary Education; Per Capita Appropriations for Higher Education, 1980-81

	Elementary and Secondary Expenditures Per Pupil		Higher Education Appropriations Per Capita	
	Dollars	As a % of U.S.	Dollars	As a % of U.S.
United States	$1,899	100%	$ 82	100%
Alabama	1,333	88	110	120
Arkansas	1,277	84	82	89
Florida	1,991	88	72	78
Georgia	1,443	76	79	86
Kentucky	1,695	84	84	91
Louisiana	1,890	99	95	103
Maryland	2,374	125	87	94
Mississippi	1,299	91	104	113
North Carolina	1,623	82	113	122
South Carolina	1,341	99	110	120
Tennessee	1,489	78	74	80
Texas	1,489	78	103	112
Virginia	1,691	89	95	103
West Virginia	1,699	89	87	95

Source: Elementary and secondary data from National Education Association, Estimates of School Statistics, 1980-81 (per-pupil expenditures, less federal dollars); higher educational data from M.M. Chambers, The Grapevine.

states, with only a little movement toward uniformity. On the national scene, dependence on the property tax continued its long-term decline, and reliance on individual income taxes continued its long-term increase. Property taxes declined to 30.5 percent of total taxes in 1980, from 31.4 percent in 1979; and individual income taxes increased to 18.7 percent from 17.8 percent.

Table 3

State and Local Tax Ability and Effort, Selected Years, 1970 to 1980 in Constant Dollars, United States (1972 = 100)

Year	Ability — Amount (in thousands)	Effort (Collections) — Amount (in thousands)
1970	$104,912,697	$100,887,366
1974	120,613,245	116,126,828
1975	120,368,730	114,774,746
1976	133,468,319	128,976,869
1979	132,261,016	126,444,771
1980	132,241,366	124,939,333

Note: Deflators were the state-local deflators provided by the Bureau of the Census and projections provided by The University of Tennessee, Center for Business and Economic Research.

Sources: The University of Tennessee, Center for Business and Economic Research, and Kenneth E. Quindry and Niles C. Schoening, *State and Local Tax Performance, 1980*.

Slightly less reliance was put on general sales taxes in 1980 when compared with 1978. Table 4 indicates heavy utilization of the general sales taxes in the SREB, Mountain, and Pacific states. These taxes were especially high in Alabama, Louisiana, Mississippi, Tennessee, and West Virginia, states traditionally low in the use of individual income taxes. Four additional SREB states utilized general sales taxes in excess of 100 percent. Selective sales taxes were also heavily utilized in the SREB states (10 in excess of 100 percent) and in the Mountain states.

Property taxes were heavily utilized in the New England and Middle Atlantic states and least heavily used in the SREB states. The Pacific states' use declined drastically from 1978 to 1980 because of Proposition 13 in California. Property tax utilization averaged 73.7 percent of ability in the SREB states, ranging from 32.9 percent in Alabama to 93.6 percent in Texas. Massachusetts continued to be the highest property tax state (173.6 percent), but that is likely to change as a result of Proposition 2½.

Individual income taxes were most heavily used in the Middle Atlantic states (126.4 percent), especially in New York (174.6 percent) and Delaware (170.7 percent). Usage was least in the SREB states (51.5 percent), primarily because Florida and Texas had no tax and Tennessee only a minimal one. Maryland (160.0 percent) was among the nation's leading users of individual income taxes. North Carolina (107.2

Table 4

State and Local Utilization of Tax Ability by Major Tax Sources, 1978 and 1980

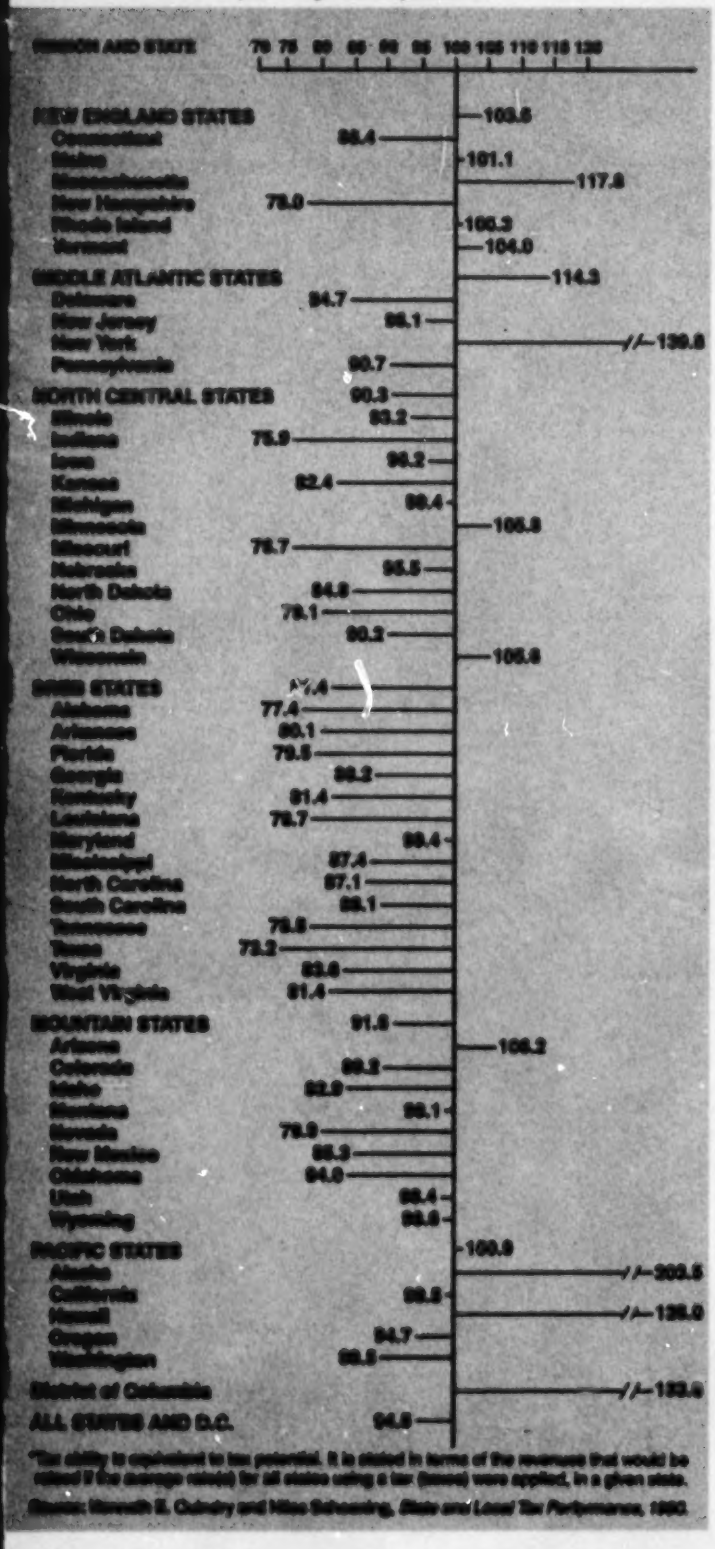
Region and State	General Sales		Selective Sales		Property		Individual Income		Corporation Income	
	1978	1980	1978	1980	1978	1980	1978	1980	1978	1980
SREB States	103.4	101.8	130.6	127.4	67.2	73.7	51.0	51.5	87.2	86.3
Alabama	113.4	110.0	183.4	203.6	28.2	32.9	61.8	60.8	51.5	54.7
Arkansas	94.7	91.1	93.0	94.2	49.2	57.3	64.1	79.2	90.2	75.9
Florida	103.0	107.5	159.3	162.4	78.2	80.0	—	—	57.7	63.5
Georgia	106.5	107.9	99.5	97.1	73.7	78.5	74.6	83.8	86.1	80.7
Kentucky	92.3	86.8	101.8	92.8	46.7	54.4	96.3	100.2	86.7	81.3
Louisiana	149.4	154.3	97.8	102.5	36.1	42.4	31.3	29.9	104.0	105.7
Maryland	72.8	67.3	109.1	105.4	86.1	86.1	156.8	160.0	53.0	56.1
Mississippi	161.3	164.5	91.4	96.4	56.1	66.7	49.4	37.7	56.2	56.5
North Carolina	79.9	76.9	109.9	111.2	57.9	66.3	97.0	107.2	89.9	92.8
South Carolina	103.8	101.9	109.1	111.7	57.0	57.5	81.5	89.4	97.5	97.1
Tennessee	149.8	143.8	143.4	124.8	57.9	63.7	3.7	3.6	87.3	81.5
Texas	97.5	92.4	151.9	135.5	85.9	93.6	—	—	—	—
Virginia	66.4	65.4	133.9	132.4	70.8	78.9	93.6	92.0	60.3	56.6
West Virginia	162.7	158.9	117.5	116.7	47.7	54.4	64.5	66.5	25.3	31.3
New England States	82.4	85.8	107.8	92.7	144.2	153.4	77.5	78.9	110.8	114.5
Middle Atlantic States	90.5	90.0	99.9	106.1	119.0	129.4	122.0	126.4	118.7	102.4
North Central States	85.4	82.9	77.5	78.4	93.4	106.4	84.8	81.1	90.8	92.4
Mountain States	121.2	116.8	102.9	101.2	91.0	96.9	80.5	85.8	87.0	86.1
Pacific States	125.4	126.6	72.9	73.8	126.6	96.5	94.7	95.5	128.8	142.7
District of Columbia	93.9	175.0	190.9	113.2	73.8	90.4	134.2	151.3	143.6	127.9
All States and D.C.	97.9	97.9	99.9	99.9	100.0	100.0	82.3	81.7	91.9	91.2

Source: Kenneth E. Quindry and Niles C. Schoening, *State and Local Tax Performance, 1978 and 1980*.

Figure 2

State and Local Utilization of Tax Ability,* By State and Region, 1980

(Percentage of Ability Utilized)



*Tax ability is equivalent to tax potential. It is stated in terms of the revenues that would be raised if the average rate(s) for all states using a tax (taxes) were applied, in a given state.

Source: Kenneth E. Quindry and Mike Schmeling, *State and Local Tax Performance, 1980.*

to "tax ability" — ability being a measure of a given state's potential for using its taxes in comparison with their average utilization by all states using those particular taxes.[3]

Only the District of Columbia and 10 of the 50 states "overutilized" their aggregate computed tax ability in 1980 (Figure 2). The range of utilization was rather broad — from 73.2 percent in Texas to 203.5 percent in Alaska. Alaska, however, was in the enviable position of having most of its revenue coming from petroleum taxes, utilizing only a nominal income tax (now repealed) and a local general sales tax. Significant underutilization (less than 85 percent) is noted in 20 states, ten of which are in the SREB region. Aggregate utilization declined to 94.5 percent in 1980, from 94.9 percent in 1979, primarily because many states reduced tax effort by lowering tax rates or granting new credits and exemptions, or simply by taking no action, as tax ability increased.

With only a few exceptions, the heavy utilizations were located in the New England and Pacific states. No SREB state exceeded 100 percent of ability. Variation around the average (which is just below 100 percent) is expected because of different economic and political circumstances in the states. The statistical measure of standard deviation from the mean, however, indicates that the states, with few exceptions, are closely clustered about the average.

Overutilization increased to $13.1 billion in 1980, up from $11.2 billion in 1979. Taxes increased by 8.6 percent (to $225 billion) and ability by 9.0 percent (to $238 billion). The SREB region exceeded the other regions in growth both of ability and effort, with effort exceeding ability growth (10.1 percent and 8.9 percent).

When adjusted for inflation in the prices of goods and services the state and local governments purchase, both ability and effort grew in the 1970s — ability by 26.05 percent, effort by 23.87 percent (Table 3). Growth, however, was not steady. During the decade, two periods of recession actually resulted in real decline in state-local taxes. From 1974 to 1975, real ability declined by 0.20 percent and effort by 1.16 percent. The declines from 1978 to 1979 were 0.92 percent and 1.21 percent, respectively; and from 1979 to 1980, they were 0.01 percent and 0.41 percent, respectively.

Utilization of Major Tax Bases

The considerable diversity in the relative use of tax sources continued in 1980 among the regions and

[3]State-local tax ability for a tax is measured as the weighted average utilization by all states using the particular tax. A state utilizes its ability when it applies the weighted average rate to its taxable base. The separate tax abilities are then totaled to compute aggregate tax ability. Effort is measured as tax collections and compared individually and collectively with ability. In most states, one or more taxes are "overutilized" and one or more are "underutilized" by applying above average or below average rates, respectively. A state utilizes its aggregate ability when "overutilization" is exactly offset by "underutilization." At this point, effort exactly equals ability. States rank above 100 percent in utilization if "overutilization" exceeds "underutilization."

Table 2

State Appropriations for Higher Educational Operations as a Percent of State Taxes Ranked Against State and Local Support of Elementary and Secondary Education 1980-81

	(I) Higher Education Appropriations as a Percent of Taxes	(II) Rank in State and Local Support of Elementary and Secondary Education
Alabama	20.3%	12
Texas	19.5	8
Mississippi	18.6	14
North Carolina	18.0	7
South Carolina	17.8	11
Tennessee	16.9	10
Virginia	16.2	4
Arkansas	14.6	13
Georgia	14.1	9
Kentucky	14.0	5
Louisiana	13.8	6
West Virginia	13.0	3
Florida	12.7	2
Maryland	11.7	1
SREB States	16.0	

Source: Column 1 updated from Table 32 in SREB, *Fact Book on Higher Education in the South, 1979 and 1980*; Column 2 based on Table 1, this report.

lower percent of state taxes to be adequate for higher education.

The SREB Task Force on Higher Education and the Schools in its report, *The Need for Quality*, calls for "more effective utilization of financial resources that support state educational systems." In pursuing that objective, states may need to evaluate the tasks that the different levels of education are expected to perform and the support that is given each sector.

Regional and State Utilization of Tax Ability in 1980

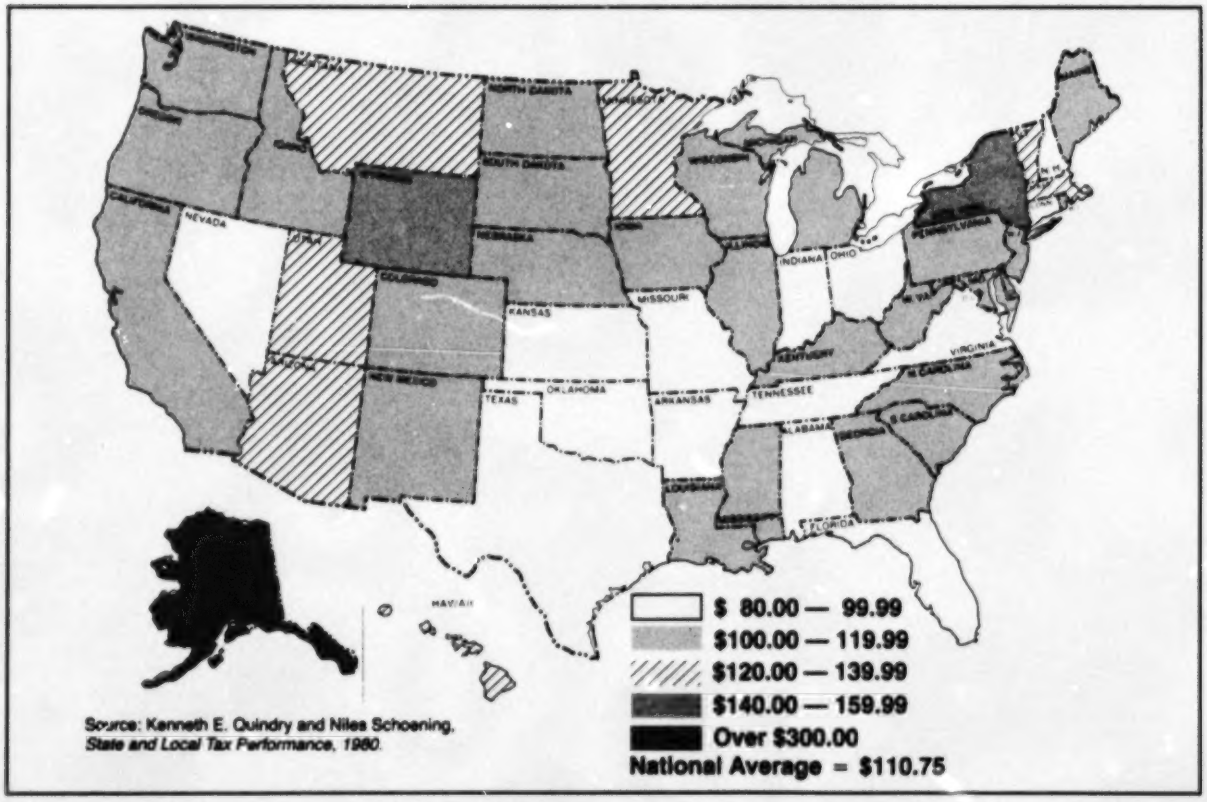
The annual analysis of state and local tax developments is published this year by the Southern Regional Education Board as a separate set of detailed tables under the title *State and Local Tax Performance, 1980*. Highlights of the analysis are summarized here.

A readily understood comparison of tax performance is offered by relating the tax collections of a state to its personal income. In 1980, state and local taxes collected in the United States per $1,000 of personal income amounted to $110.75. Among SREB states only Maryland, at $114.03, reached that amount. The effort of other states ranged from $91.60 in Texas to $109.34 in Louisiana (Figure 1).

A more revealing evaluation of state and local tax performance is the relating of tax effort (collections)

Figure 1

State and Local Taxes Per $1,000 of Personal Income, 1980



Source: Kenneth E. Quindry and Niles Schoening, *State and Local Tax Performance, 1980*.

percent) and Kentucky (100.2 percent) were moderately heavy users.

Corporation income taxes were most heavily utilized in the two East Coast regions and in the Pacific states. The SREB states trailed regionally (56.3 percent) because Texas does not utilize the tax; only Louisiana (105.7 percent) exceeded the average national usage. From that high, the SREB states ranged down to 31.3 percent in West Virginia.

New Tax Developments

For 1980 and 1981, tax and spending reductions were again somewhat more common than tax increases. However, a few tax increases did occur in the most financially strapped states. The most popular approaches were to speed up collections by various techniques without raising rates, or to increase excise tax rates. Gasoline and fuels tax increases led the list (19 states and the District of Columbia in 1981). Other 1981 increases were general sales taxes in Ohio (temporary), Nevada (temporary), Minnesota, and West Virginia. Ohio enacted a new severance tax on coal, and a few states raised their existing severance taxes. Montana's 30 percent severance tax was upheld by the U.S. Supreme Court. Nevada and Wisconsin levied new taxes on tobacco products and Wisconsin raised its corporation income tax.

Tax reductions or extended exemptions were almost equally numerous. Alabama extended its existing exemptions from sales taxes, and New Mexico provided additional income tax credits. Three states reduced corporation income taxes (Colorado, New Mexico, and North Dakota). Gasahol continued to be taxed at a reduced rate in about one-third of the states. Income taxes were indexed in 10 states, with adoption by South Carolina becoming effective January 1, 1981. Tennessee continued to phase out its sales tax on farm and industrial machinery and equipment — to be completed in 1983. New property tax homestead exemptions were approved in five states in 1980 (Arkansas, Louisiana, New Jersey, Virginia, and West Virginia), and the property tax circuit breaker relief was increased in Illinois. A few excise taxes on beer and other alcoholic beverages were increased. By 1981, three-fifths of the states had authorized income, sales, or property tax credits or exemptions.

Voter initiatives to restrain taxes and/or spending were relatively ineffective in several states, with the exception of California and Massachusetts. In those states local sales taxes were held down and the states were running short of funds to replace lost local revenue. California's excessive surpluses were largely depleted in 1981. Both states now face severe cutbacks and the possibility of tax increases as a result of the "tax revolt."

This issue of *Financing Higher Education* is based on material provided by Kenneth E. Quindry and Niles Schoening of the Center for Business and Economic Research, College of Business Administration, The University of Tennessee, Knoxville. Complete tabulations are available from the Southern Regional Education Board: Quindry and Schoening, *State and Local Tax Performance, 1980*, $3.00.

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